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NSC review completed

OTHER EAST-WEST ISSUES

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Although U.S. sanctions and the Siberian pipeline form the most contentious East-West economic issue dividing us and our Western allies, there are others on which differences have arisen, or may potentially develop. These include: (1) the U.S. initiative to obtain agreement on restraints on officially-backed credits to the Soviet Union; (2) rescheduling of Poland's debt; and (3) strengthening COCOM.

BACKGROUND

There is a gap between some elements of the U.S. approach to East-West economic relations and that of our West European allies. The decision to extend and expand sanctions did not create this gap; it did make it clearer. Our long-range objective is to develop a common approach which will reinforce Allied solidarity. In the short run, we must overcome the divisions within the alliance, thus denying the Soviets an opportunity to pry it further apart.

There are three general attitudes that can be adopted towards the question of East-West trade and financial relations. First, one could make the case that any economic relations between Western countries and Communist countries are inevitably of greater benefit to the latter than to the former. This is principally based on two arguments. One is that trade and finance are much more important to the Communists, given the manifest failures and inefficiencies of their economic system. Another is that, on the Communist side, trade is conducted by and through state trading combines, which are able to play Western firms off against each other because of their monopoly seller or monopsony buyer position and obtain below-market terms and conditions.

Our problems with the Europeans arise in part from the different choices we have made between the other two alternatives. The position of the European countries by and large is that economic relations between Western and Communist countries serve to tie the latter to the former, at least to some degree, and thus provide a moderating element to the calculations of the Soviet Bloc. The very dependence of the Bloc on foreign economic relations to keep its economy going is a guarantee that it will be loath to disturb those arrangements. In any case, massive Soviet orders keep factories operating and save jobs, and it would be masochistic to reject them. Additionally, Soviet exports are made up largely of raw materials which the Western countries need. Using Soviet sources diversifies supply and adds to international competition, thus moderating prices. (This was also the economic reasoning underlying the policy of detente.)

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While recognizing some merit in the first position and the logical and political attractiveness of the second, the Reagan Administration has adopted an intermediate attitude towards East-West economic relations. Detente has not, in fact, had the hoped-for effects. The Soviet military buildup and foreign adventurism have not moderated -- indeed they have greatly increased. On the other hand, the first attitude underestimates the bargaining ability of the Western corporate trading companies. Thus, trade and finance carried on in commercial terms and following commercial considerations are of approximately equal benefit to both sides and should be encouraged to the same extent that all external commercial relations are encouraged, so long as the terms and conditions of these relations are not skewed by official guarantees and/or subsidized interest rates. It is ridiculous that Western taxpayers are forced to pay for East-West trade on terms disadvantageous to the West, which adds net resources to the Soviet Bloc, enabling it to accelerate its military buildup and foreign adventurism.

There are two exceptions to this position: one is trade in military or dual-purpose equipment or technology and the other is when egregious behavior on the part of the Bloc, such as the imposition of martial law in Poland leads to the imposition of economic sanctions. It is the U.S. Government's application of these exceptions that has generated problems with the Europeans over the three issues discussed below.

Restraints on Credit to the Soviet Union. The prospects for the U.S. initiative for restraints by Western governments on credits to the Soviet Union are uncertain. As developed and discussed with the Europeans, our proposal was for an agreement to restrict officially-backed credits to the Soviets. Our analysis of the Soviets' economic and financial prospects indicated that they would need to borrow substantial amounts from the West to finance their import needs, and could thus build up a substantial debt. A principal rationale for a credit restraint agreement was that it would forestall this build-up and thus deny the Soviets the reverse leverage it would entail. We also hoped to make their resource allocation decisions more difficult at the margin.

In a series of meetings from mid-March to the Versailles Summit in early June, Under Secretary Buckley and other high-level U.S. officials tried to persuade the Europeans to join us in a credit restraint agreement. Ultimately, we were unsuccessful. However, we did get communique language and a periodic review procedure that could enable us to continue to press the point with the Europeans.

Soon after the Summit, we began to lay the groundwork for the post-Summit phase of our effort. Concentrating first on improving collection of data on financial flows, we have raised the possibility of bolstering NATO's system and are making a

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similar pitch in the OECD. Some European officials, professing to be outraged over our extension of our export controls, have said that all Summit agreements for follow-up action are no longer valid. It is too early to predict what will happen, but such attitudes could jeopardize our effort to get improvements in data collection in this area as well as in any future monitoring proposal.

Eastern European Debt. The Polish and Eastern European debt situation, which had reached serious proportions by the latter part of 1981, took on an air of crisis when the Poles imposed martial law on December 13, 1981. In reaction to the Polish crackdown, the United States and its allies agreed not to reschedule Poland's 1982 maturities until martial law had been lifted; the political prisoners were released; and a dialogue was resumed among the government, the Church, and Solidarity.

Some Europeans, especially the Germans and British, are now showing signs of wanting to walk away from those conditions and reschedule the Polish debt. However, this has not yet become a major point of difference between us.

The Polish crisis exacerbated the difficult financial situation which other Eastern European countries were already experiencing. It made explicitly clear the falsehood of the "umbrella theory" and caused a further reduction in banks' lending to Eastern Europe.

These countries' debt situations have been dealt with through existing institutions and have not become a major source of contention among the Allies. Romania has reached agreement with the IMF for a one-year standby program, and a Paris Club rescheduling is getting underway; Hungary, which recently joined the IMF, may seek a standby this fall and in the interim is using the Bank for International Settlements (BIS) to raise funds to augment its reserves. Yugoslavia (not a member of the Warsaw Pact), which got caught in the backlash of this situation, also has an IMF program underway.

COCOM. A major effort in the direction of reducing the flow of Western technology to the U.S.S.R. that strengthens its war-making capabilities, was taken last January at the COCOM high-level meeting (HLM). The HLM provided the political guidance and philosophical umbrella needed to revitalize COCOM and strengthen multilateral controls on strategic trade. The United States now faces the task of negotiating and implementing the decisions taken at the HLM. This will require a major bilateral and multilateral effort if the United States is to be successful in restructuring COCOM.

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U.S. goals for the HLM, considering the fact that it was the first political level meeting of the group in over 25 years, were largely achieved. The members basically reached a political agreement to:

1. Strengthen controls, placing more emphasis on controlling technologies and equipment critical to the Soviet military-industrial base, and decontrol less strategic items;
2. pursue a program of harmonizing national control systems, including licensing rules and procedures; and
3. strengthen the enforcement of controls world-wide.

Subsequent to the HLM the COCOM Subcommittee on Export Controls met in late May to consider the twin issues of improved enforcement and measures for harmonizing the licensing process. Although some forward process was achieved, it was less than anticipated. The HLM guidance did not prove completely adequate to achieve changes in direction or harmonization and enforcement but members agreed to continue examining the issues. The United States has submitted most of the technical proposals to restructure the COCOM List and will engage in negotiations starting this fall. The proposals followed the HLM guidance by strengthening technology while decontrolling nonstrategic items.

These proposals will not meet with ready acceptance by our Allies. However, we are proceeding in confidence that COCOM will work, provided that we are willing to limit its controls to military-related items.

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